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Britain's Economic Troubles and the Labor Government

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BRITAIN'S ECONOMIC TROUBLES AND THE LABOR GOVERNMENT

After nearly three years in office Prime Minister Harold Wilson's Labor government continues to grapple with economic problems. A program of economic austerity adopted after the July 1966 sterling crisis was designed to restore confidence in the pound and provide time for restructuring the economy. The program's various measures, including a controversial wage-price freeze, have been successfully carried out, but the resulting performance of the economy has not fulfilled expectations in several crucial respects. As a consequence, the government has had to delay again any attempts to stimulate economic expansion.

Opposition to the government's economic programs is growing and comes mainly from left-wing Laborites and the party's trade union supporters. Wilson still retains enough parliamentary and public support to offset his domestic opponents. Bitter denunciations of the prime minister and his policies, however, will fill the air at the annual conferences of the Trade Union Congress and the Labor Party this fall, and Wilson will have to use his political talents skillfully to prevent simmering opposition from breaking out into open political revolt.

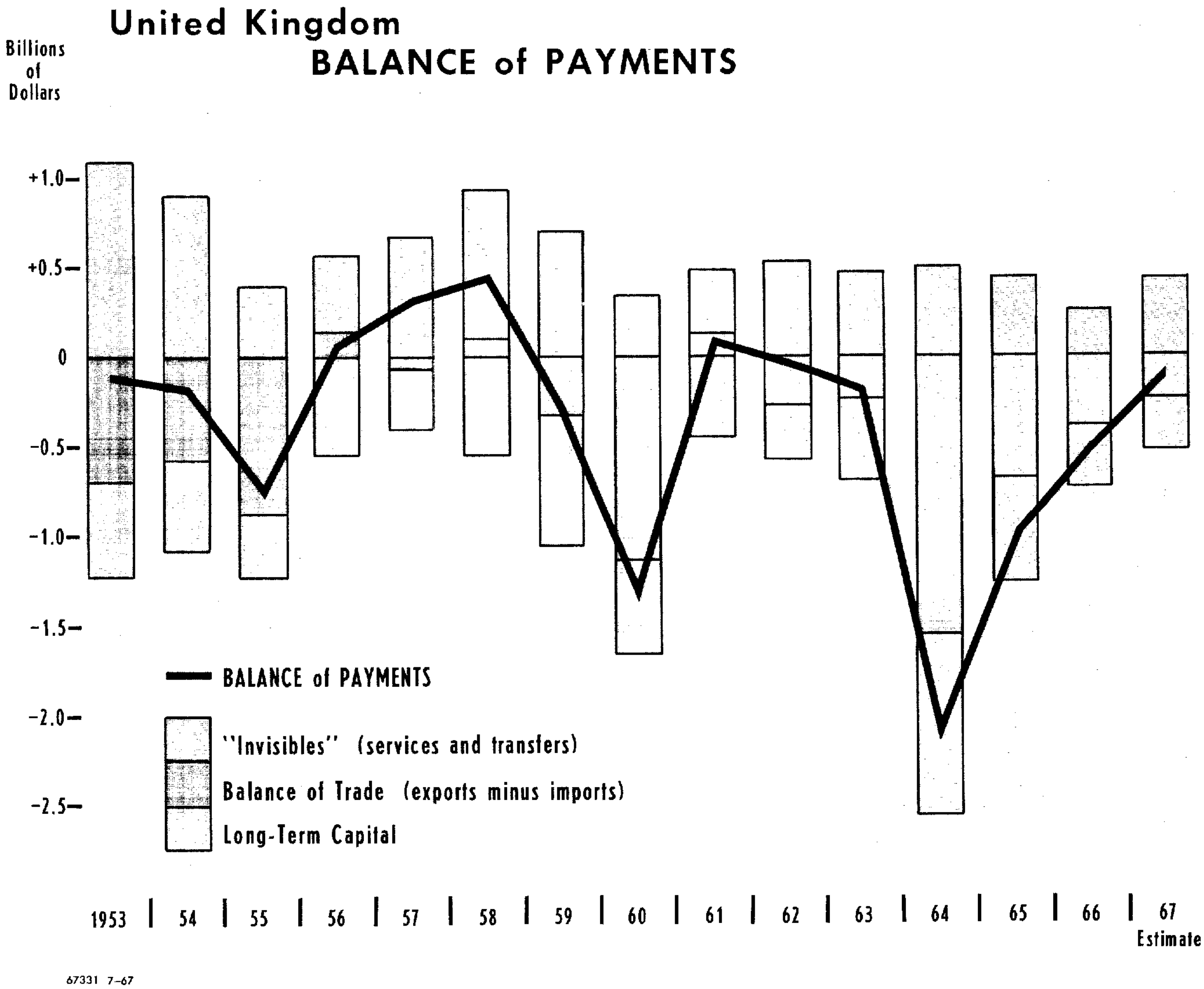
The country's economic woes also have restricted the government's freedom of action in foreign policy and defense matters. They have hastened Britain's bid to join the European Communities and influenced the decision to abandon its military role east of Suez.

Pressure on the Pound

The Labor government has been a virtual prisoner of Britain's economic malaise since coming to power in October 1964. It inherited a severe balance-of-payments problem from the Conservatives, who had faced recurring sterling crises during their 13 years in office.

To restore confidence in the pound and avoid devaluation, the Wilson government after only a few weeks in office put a surcharge on imported manufactured goods, imposed restraints on demand, and raised the bank rate. Devaluation was staved off, however, only by drawing heavily on emergency credits--totaling $3 billion--provided by US and European central banks and the International Monetary Fund. With these the Bank of England was able to buy large quantities of sterling and drive off speculators.

The government's strategy was to couple moderate restraint of demand with more direct measures to save or earn foreign exchange and a prices and incomes policy based on voluntary compliance. These measures succeeded in cutting the payments deficit from slightly more than $2 billion in 1964 to less than $1 billion in 1965. In early 1966, consumer spending, stimulated by sharply rising wages--along with soaring imports and a large outflow of long-term capital--caused a



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substantial first-quarter deficit. The government reacted by instituting several programs to restrict investment abroad, to reduce governmental spending overseas, and to stimulate exports. The impact was not to be felt for several months.

A seamen's strike beginning in May 1966, trade union objections to even mild controls on wages and prices, and a widespread feeling that the government was drifting in the face of a clear need for strong action brought sterling under strong pressure in June and early July. Wilson again rejected devaluation as a remedy, and the value of sterling was maintained at the cost of further liquidation of the government's portfolio of US securities, large-scale drawings on foreign central bank credits, and by the toughest austerity measures since World War II.

Wilsonian Austerity

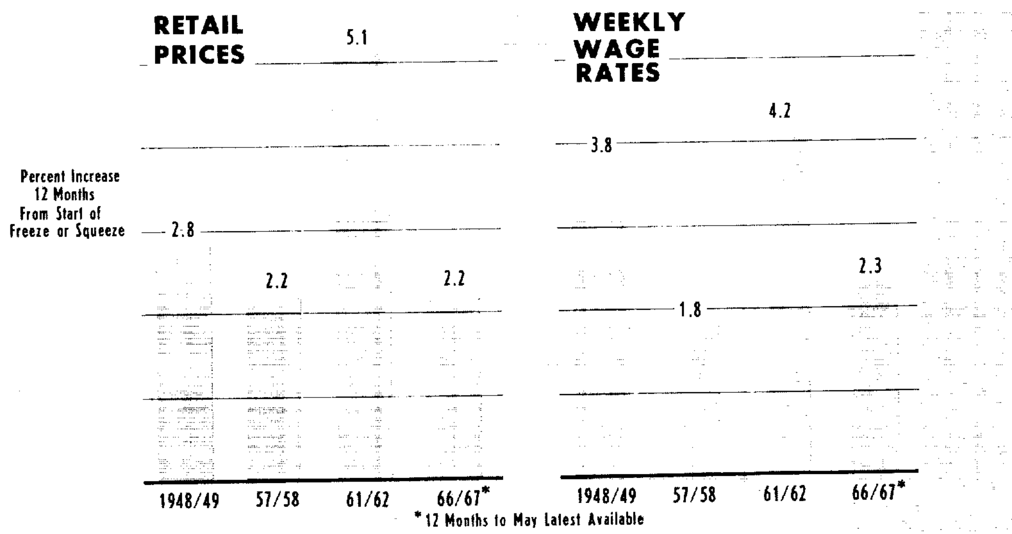
The key element in the government's effort to deflate the economy was a statutory wage-price freeze. The success of this measure, because it required the acquiescence of the British people, especially the Labor Party's trade union supporters, was psychologically important to the success of the entire program.

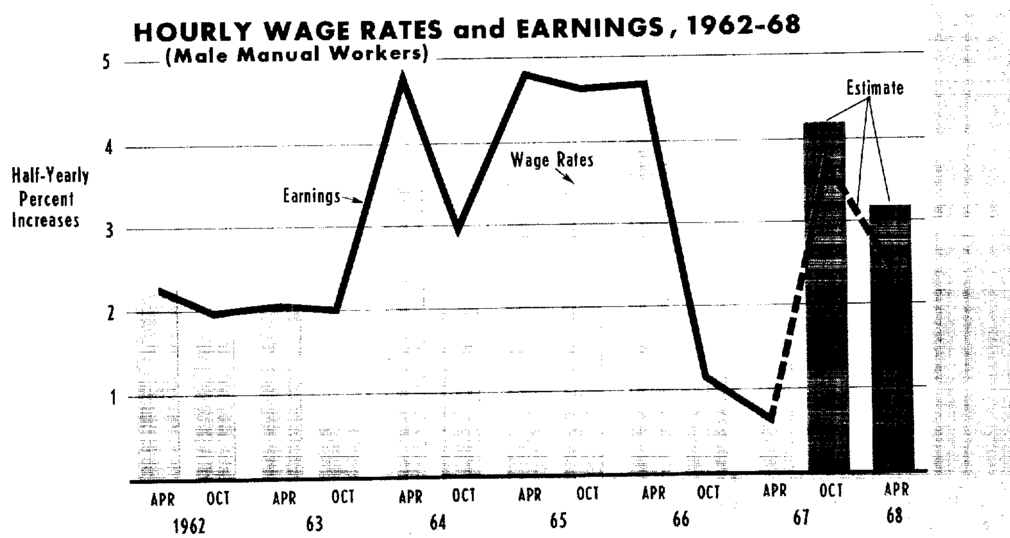
The enactment and subsequent enforcement of the wage-price freeze demonstrated to skeptical financial circles in Britain and abroad the government's determination to make the tough deflationary program effective. The government also pledged to cut its expenses, reduce overseas defense outlays, and obtain Bonn's agreement to pay the foreign exchange costs of British forces in Germany. It also promised measures to limit the outflow of investment and curtail British tourists' spending abroad. These steps, moreover, envisaged a rise in unemployment which the government hoped would force a redeployment of labor into the export industries. The more rapid growth of these industries would be stimulated by existing tax incentive programs.

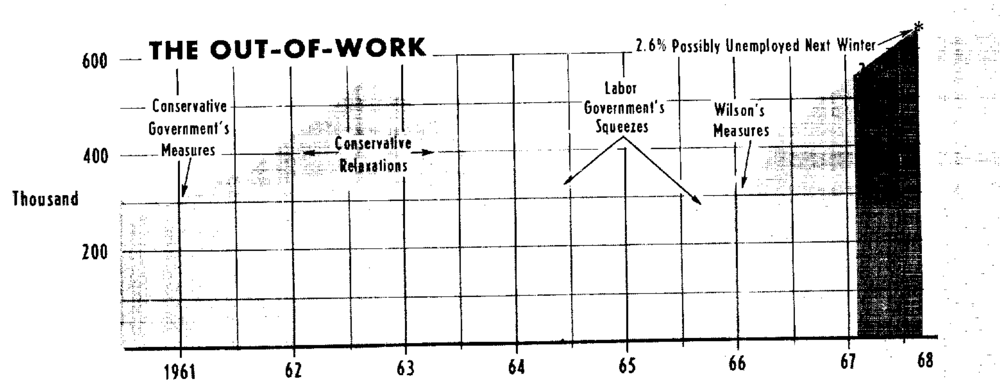
The statutory, year-long freeze ended on 20 July 1967, but was quickly replaced by a strong new prices and incomes law. The freeze had been effective, keeping to little more than a 2-percent increase wage rates which had been rising at an annual rate of 7 percent during the 18 months before July 1966 and prices which were going up at 4.5 percent. This success depended mainly on widespread acceptance by management and labor of the need for austerity.

The government will have the power for a year from 12 August 1967 to hold up increases in wages or prices for a total of seven months. It will allow some rises in both after the 20 July expiration of the freeze but enable the government to spread the increases out and thereby lessen their impact. Millions of workers are expecting this summer pay raises which have been deferred during the past year. Increases for many others will be negotiated

United Kingdom
A COMPARISON of RECENT AUSTERITY PERIODS







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this summer and fall. Producers can be expected to pass these increases along, and may also seek to improve depressed profit margins by raising prices.

London will be hard pressed to maintain the voluntary cooperation of the past year and has itself contributed to the expectations of a relaxation in the austerity program. In response to public dissatisfaction with high unemployment and slow economic growth, the government in June eased some forms of credit and announced increases in social benefits to take effect this fall and next spring. The effect of these measures is more psychological than real and they do not in themselves lay the base for renewed inflation.

Continuing Economic Woes

The performance of the economy during the first half of 1967 has not met the government's announced targets. London had planned for a 3-percent economic growth rate during 1967 and for a balance-of-payments surplus of some $400 million during the year. The growth rate, however, hovered around one percent during the first half of the year, and the government now reportedly expects no more than a 2-percent growth for the year as a whole. Speaking in Parliament on 24 July, Chancellor of the Exchequer James Callaghan said he saw no reason to alter government expectations that the level of output would grow "from now on" at 3 percent.

The balance of payments has shown a small surplus during the first quarter although the trade performance has been disappointing. Import levels have remained high while exports have been lagging. The slowdown in economic activity in Western Europe and the United States has been a major factor hampering the growth of British exports. The recession in West Germany--Britain's third largest customer last year--has caused British sales there to fall sharply. Meanwhile, unemployment in the UK continues to rise, and industrial production shows no sign of an upturn. Investment for the year is expected to be 7-10 percent below 1966.

The persistence this year of Britain's balance-of-payments problems has not yet resulted in heavy pressure on sterling. Unless the figures for the next few months markedly change the picture, however, the government will probably come under strong pressures from economic and financial circles at home and abroad to retain restraints on demand, to impose direct controls on imports, to make more cuts in government overseas spending, or to devalue the pound. Wilson has thus far firmly ruled out devaluation.

The prospects for achievement of a payments surplus over the year are not promising. The third quarter is traditionally

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not a good one for the balance of payments, and the troubles in the Middle East have made things worse. The British are being denied the income from some of their oil investments in the area, and the Arab boycott on oil shipments is forcing them to buy more expensive oil elsewhere.

Growing Opposition

The government has had to contend with intense criticism of its economic policies, principally from left-wing Laborites. The increase of Labor's parliamentary majority to nearly a hundred in the March 1966 general election allowed the dissenters the freedom of action denied them when the government's majority could be counted on one hand. The 30 or so hard-core rebels, who have focused their attack on the wage-freeze aspect of the government's economic program, have also been vociferous in opposing the government's retention of even a sharply reduced military presence overseas, and Britain's bid for membership in the Common Market.

That Wilson's troubles have come from his own party is not surprising--Labor has always suffered from varying degrees of factionalism. It is ironic, however, because the prime minister's standing with the general public is still fairly high and the Conservatives have not been an effective opposition. Moreover, the trade unions, who might have crippled the wage freeze, have been unexpectedly cooperative.

The wage standstill won narrow acceptance--a margin of 344,000 of the 8.8 million votes cast--at the annual convention of the Trades Union Congress (TUC) last fall. Despite this small margin, the endorsement helped secure acceptance by individual unions and by the annual conference of the Labor Party.

Frank Cousins, head of the Transport and General Workers Union (TGWU), has been the loudest trade union voice opposing the government's economic policies. Cousins resigned from the cabinet a year ago to protest them, but has succeeded in rallying few trade union leaders to his cause. Under Cousins' guidance, the TGWU, Britain's largest labor union, at its convention last month passed a resolution which will allow the union to withdraw financial assistance from Labor MPs who do not strongly support its interests. The measure is unlikely to have much impact, though such action is unprecedented. It does suggest, however, that organized labor is not only disgusted with the government's policies but disenchanted with the parliamentary leadership. Moreover, it foreshadows a hard time for the government at this fall's TUC conference.

While trade unionists have refrained from challenging the wage freeze, they have displayed their dissatisfaction at the polls. In March and April, Labor candidates fared badly in a series of parliamentary by-elections and in local elections. Most major cities fell to the Tories, including London, which Labor had controlled since 1934. A low voter turnout indicated that many voters were dissatisfied with Labor, but did not yet see the Conservatives as an acceptable alternative.

The Tories' victories have bolstered their morale, and in some areas have laid the groundwork for a revitalization of the party organization. They have also strengthened somewhat the position of Conservative leader Edward Heath. Wilson's use of traditional economic remedies which the Conservatives have supported in the past, however, has made it difficult for them to develop attractive alternatives.

Europe and East of Suez

Britain's limited economic resources have restricted the government's room to maneuver on foreign policy and defense questions. Economic problems hastened the government's decision to try to join Europe and to abandon most of the country's overseas defense commitments. In 1966, as the economic freeze affected British society, the government began to take a new look at Europe. George Brown, a European enthusiast, moved into the Foreign Office and was instrumental in converting the prime minister to support of Common Market membership. Wilson's conversion was made easier by evidence that the British public favored membership in the Communities and by the realization that he would be denying the Tories an attractive issue at the next general election.

In his quest for Common Market membership, Wilson feels that the image Britain creates in the minds of the policy makers of the Six is of vital importance. The British nation must appear united behind Wilson's policies toward Europe. Britain's economy must appear strong and well on its way to full and lasting recovery from last summer's sterling crisis. If either image breaks down badly, some of the momentum behind London's effort to join Europe might be lost.

Economic problems have accelerated Britain's decision to cut back sharply on overseas defense commitments. The supplementary Defense White Paper released in London last month set forth Britain's intention to withdraw its forces from Singapore and Malaysia by the mid-1970s. It announced cuts in the armed forces which by that same period are likely to reduce their strength from 417,000 to some 340,000, with a corresponding reduction in civilian employees. These cuts are expected to enable the government to stay below its target of a $5.6-billion annual defense budget (at 1964 price levels) over the next several years.

The British have sought to offset the security and economic impact of all the planned withdrawals, but have made it clear that the decisions to pull back are irreversible. The government has said it will grant Singapore

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and Malaysia financial aid and stand by its security commitments to them, although it has not said how. Earlier, London agreed to extend the stay of British troops on Malta for a short time. A serious effort has been made to create a viable federal government and security force in South Arabia before the UK's departure next January.

The British military presence in Europe has not been altered significantly and probably will not be as long as the foreign exchange cost is not high. All but about $28 million of the some $230 million that it costs the UK to maintain the British Army of the Rhine is offset by West German and American purchases of British goods. The redeployment early next year to Britain of one army brigade and one air squadron is expected to save an additional $15 million in foreign exchange. The offset agreements must be renegotiated annually, and London will consider further troop reductions if satisfactory arrangements to meet its balance-of-payments needs are not reached. The British, however, will be reluctant to cut their military ties to Europe when they are seeking closer political and economic ties.

Outlook

The pressures on the Wilson government to take action to stimulate growth in the economy will mount in the coming months, if economic indicators do not show marked improvement over their performances during the first half of 1967. Seventy-one Labor MPs, for example, have issued a manifesto calling for a resumption of economic expansion. They urge the liquidation of part of the UK's overseas investments, the introduction of selective import controls, further reductions in defense expenditures, and the stimulation of the economy by an expansion of social services. They do not rule out devaluation. These critics are particularly concerned about unemployment which now stands at half a million and could reach 700,000 this winter. Although the latter figure is less than 3 percent of the total labor force, almost any unemployment becomes a heated political issue in Britain.

These political pressures do not threaten the government. Wilson will probably continue to resist them, but his political mettle will be thoroughly tested in doing so. In April, even though confidence in sterling was high and the balance of payments showed a small surplus, the government presented a budget with a neutral effect, because it did not feel the time was right for deflation. The outlook since then has not been bright enough to change the government's thinking.

The Wilson government still hopes that the short-term measures will be adequate to prevent a run on sterling, thereby giving its programs, designed to effect permanent improvement in the economy, chance to take effect.

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The danger remains that a particularly bad piece of economic news or a major domestic or international crisis will bring heavy pressure on sterling. Equally worrisome to London's policy makers is the possibility that Britain's balance of payments will fail to improve significantly over an extended period. The resulting loss of confidence in economic and financial circles at home and abroad would bring calls for further drastic action. This pressure is less easily brushed aside than that from domestic political critics concerned mainly with full employment and economic growth. The government's remaining alternatives range from the institution of import controls, which are difficult to administer and unpopular abroad, to devaluation. [redacted] 25X1

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